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In the Supreme Court of the United States

OCTOBER TERM, 1962.

No. 340

IN THE MATTER OF SUMMIT HARDWARE, INC.,
Bankrupt.

EVERETT L. FOOTE,
Petitioner,

vs.

JOHN A. SCHWEMLER,
Trustee in Bankruptcy,
Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

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PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Sixth Circuit.

To the Honorable Chief Justice and Associate Justice of the Supreme Court of the United States:

Your petitioner, Everett L. Foote, respectfully prays that a writ of certiorari may issue herein to review the judgment of the United States Court of Appeals, which judgment of the Court of Appeals reversed the judgment of the District Court of the Northern District of Ohio, Eastern Division, which judgment of the District Court had sustained the validity of a factor's lien, in the sum of Twenty-five Thousand Dollars ($25,000.00), held by your petitioner, Everett L. Foote.

OFFICIAL AND UNOFFICIAL REPORTS IN LOWER COURTS.

The Referee in Bankruptcy's finding and opinion is unreported. It is set forth as A in the appendix hereto, page 12.

The judgment of the District Court is officially recorded in 192 Fed. Sup. 489, under date of January 6, 1962, and is set forth as B in the appendix hereto, page 27.

The judgment of the United States Court of Appeals, reversing the District Court, is officially reported in 302 Fed. (2) 397, under date of April 19, 1962, set forth as C in the appendix hereto, page 33.

AS TO JURISDICTION.

The date of the entry of the judgment of the Court of Appeals, sought to be reviewed, is April 19, 1962.

Petition for Rehearing was filed by your petitioner in the Court of Appeals on May 8, 1962, and was denied by the Court of Appeals (without opinion) on May 16, 1962.

The jurisdiction of the Supreme Court of the United States is here invoked:

1. Under the provisions of 28 U. S. C. A., Sec. 1254 (1), granting the Supreme Court the jurisdiction to review the decisions of Courts of Appeals by writ of certiorari;

2. Under the provisions of 11 U. S. C. A., Sec. 47-(c), vesting the Supreme Court of the United States with jurisdiction to review judgments, decrees, and orders of the United States Courts of Appeals in proceedings in bankruptcies; and

3. Under Supreme Court Rules, part V, Rule 19-(b).

QUESTIONS PRESENTED.

1. Was the appeal from the District Court to the Court of Appeals timely taken? The decree of the District Court was entered by the Clerk on January 6, 1961. The Clerk gave immediate notice of the said entry to all counsel and to the Referee. The appeal was taken on March 7, 1961, after the statutory time for appeal had expired.

2. Did the District Court have jurisdiction and power, after the time for appeal had expired, to grant an extension of time within which an appeal might be taken from the District Court under Rules 73(a) and 77(d) of Civil Procedure?

3. Where a written agreement, dated December 17, 1957, creating a factor's lien, uses the statutory definition of merchandise covered by the lien, and where such written agreement, in addition, refers to "a list of which is attached hereto marked Exhibit A," which Exhibit A is not attached to such written agreement, but which list of merchandise is compiled as a year-end inventory, as of the date of December 31, 1957, and later furnished to the factor by the borrower shortly thereafter, does such fact vitiate the factor's lien, where no creditor was misled by such delay and where no creditor sought at any time to determine what merchandise was covered by the factor's lien?

4. Where a statute requires an express consensual agreement upon which to predicate a legal factor's lien and where the agreement may not have been in exact or strict conformity to the statute, can such agreement creating a lien be enforced as an equitable lien, where creditors have statutory notice of the existence of such agreement creating a factor's lien?

OHIO STATUTORY PROVISIONS INVOLVED.

The pertinent Ohio statutory provisions involved are:

Page's Ohio Revised Code, Title 1, General Provisions, Ch. 1, Sec. 1.11;

Page's Ohio Revised Code, Title 13, Commercial Transactions, Ch. 1311, Liens, Sec. 1311.59 (A), 1311.60, 1311.61 and 1311.62.

Section 1311.61 provides for the filing and recording of the notice of a factor's lien. Here the timely filing and substance of the recorded notice of lien is admitted. The above-cited sections, so far as pertinent, appear in the appendix as E, page 46.

STATEMENT OF THE CASE.

The Summit Hardware, Inc., the bankrupt, was engaged at Akron, Ohio, in the retail hardware business.

On December 17, 1957, your petitioner, Everett L. Foote, loaned the Summit Hardware, Inc. the sum of Twenty-five Thousand Dollars. This loan was evidenced by a promissory note in the sum of Twenty-five Thousand Dollars. It was secured by the execution of a factor's lien agreement, as provided by R. C. Sec. 1311.60. Statutory notice of the existence of this factor's lien was filed with the recorder, one day later, on December 18, 1957. The factor's lien agreement and the notice of this lien appear in the appendix as F, page 47. The factor's lien here involved was not given to secure an antecedent debt. The moneys here loaned did not involve future advances or loans to be made to the bankrupt over a future period of time. The total sum of Twenty-five Thousand Dollars was loaned to the bankrupt in a single sum, at the time of the

execution of the factor's lien agreement. The moneys loaned were used by the bankrupt to pay past due accounts, bills, and to purchase merchandise.

The Ohio Statute does not require such a factor's lien agreement to contain a specific itemization of the articles of merchandise which are to serve as security for the repayment of the loan. The factor here, out of abundance of precaution, after describing the merchandise in the statutory language, added, "a list of which is attached hereto marked 'Exhibit A' and made a part hereof." Such exhibit, however, was not attached at the time of the execution of the agreement. Being close to the time for the taking of the year-end inventory, it was agreed that the year-end inventory should be furnished by the bankrupt, to the factor, as a substitute for the Exhibit A specified in the factor's lien agreement.

This inventory was completed on December 31, 1957, and was furnished to the factor by the borrower shortly thereafter. The factor's lien agreement provided that the bankrupt was to furnish to Everett L. Foote, the factor, a list of all merchandise acquired by it each thirty days, or oftener, if demanded, and a list of all merchandise which it had on hand. These statements were furnished by the bankrupt, as provided in the factor's lien agreement.

On September 25, 1958, an involuntary petition in bankruptcy was filed against the Summit Hardware, Inc. and it was thereafter adjudicated a bankrupt.

On December 17, 1958, the trustee filed a petition to sell the merchandise in the possession of the bankrupt. Everett L. Foote was made a party to this action. Foote filed his cross-petition for reclamation of the personal property, which the Trustee sought to sell. The Referee ordered

a sale of all of the merchandise, without first determining the validity of the factor's lien held by Foote, but did order a transfer of Foote's alleged lien, to the funds derived from the sale.

After the sale so made by the trustee, the Referee in Bankruptcy denied the validity of Foote's lien.

Foote then filed his petition for a review of the Referee's decision. The District Court determined that Foote's lien was valid and had attached to the merchandise of the bankrupt sold by the trustee. The order of the District Court, accordingly, reversed the order of the Referee and remanded the matter to the Referee for compliance with the District Court's order.

This decision of the District Court was made on January 6, 1961. The order was entered by the Clerk on his docket under the same date and the Clerk immediately gave notice of the order made by the District Court to counsel for the trustee and to the referee.

Counsel for the trustee did nothing until after the time for the taking of an appeal had expired. After the time for the taking of an appeal had expired, counsel for the trustee then sought an order in the District Court, to extend the time for the taking of an appeal. The District Court allowed the extension, despite the fact that trustee's counsel knew of the entry of the order of January 6, 1961. The trustee accordingly filed his notice of appeal on March 7, 1961, after the time for the taking of an appeal had expired.

After the appeal had been docketed in the Court of Appeals, the Appellee, Everett L. Foote, filed his motion to dismiss the said appeal on the ground that the appeal had not been timely taken and for the reason that the District Court had no power to make said order, extending the

time for the taking of an appeal, and that the order of the District Court was contrary to Rules 73(a) and 77(d) of Civil Procedure. This motion to dismiss this appeal was heard by a single member of the Court of Appeals and was overruled. The question of the timeliness of the appeal was again made on trial before the three members of the Court of Appeals. No ruling, however, was made on this point by the Court of Appeals.

The Court of Appeals entered its order reversing the order of the District Court, thereby holding the factor's lien of the said Everett L. Foote to be invalid, one of the judges (J. Magruder) dissenting.

A petition for rehearing was filed on May 8, 1962, by the lien claimant, Foote. The petition for rehearing was denied by the court on May 16, 1962, Judge Magruder dissenting.

REASONS FOR GRANTING WRIT OF CERTIORARI.

I.

As to Jurisdiction of the Court of Appeals.

The appeal from the District Court to the Court of Appeals here was not timely taken. Under such circumstances, the Court of Appeals acquired no jurisdiction.

The District Court's order was made on January 6, 1961. This order was entered on the docket on the same day. The Clerk of the District Court, on the same day, mailed copies of the order to all counsel involved and to the Referee. Counsel for Trustee admitted receipt of the copy of the District Court's order.

After time for appeal had expired, Trustee, on March 7, 1961, filed a motion to extend the time to appeal, which the District Court granted. The District Court, however,

could not extend the time for filing of the appeal, where the Trustee had actual knowledge of the entry of the order.[1]

The motion of the petitioner, Foote, to dismiss the appeal should have been sustained by the Court of Appeals. The order of the Court of Appeals overruling petitioner's motion to dismiss is contrary to the decisions of other Courts of Appeals on the same matter.[2]

II.

As to Compliance with Ohio's Factor's Lien Statute.

Ohio Revised Code, Sec. 1311.60, does not require a specific itemization of the merchandise covered by the factor's lien. It contemplates a lien on floating merchandise which will change from day to day. Ohio's factor's lien statute (as well as those of twenty-one other states)

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[1] Rule of Civil Procedure 54(a) provides that an order is a judgment, if appealable. Rule 58 provides that a notation of a judgment on a civil docket constitutes the entry of judgment. Rule 77(d) provides that lack of notice of the entry by the clerk does not affect the time to appeal or authorize the court to relieve a party for failure to appeal within the time allowed, except as permitted by Rule 73(a). Where a litigant has actual knowledge of the entry of the order, Rule 73(a) has no application.

[2] *Beacon Fed. Sav. & Loan Asso. v. Fed. Home Loan Bank*, 266 Fed. (2) 246, Syls. 1 and 2;
Butts v. Clancy, 123 Fed. (2) 250;
Deena Products v. Brick & Clay Workers, 195 Fed. (2) 612;
Edwards v. Doctor's Hospital, 242 Fed. (2) 888;
Hart v. Knox County, 171 Fed. (2) 45;
Matteson v. United States, 240 Fed. (2) 517;
Namoff v. Electrical Sup. Co., 275 Fed. (2) 14, Syl. 1;
Polara v. World Air Lines, 179 Fed. Sup. 957;
Repan v. Am. Pres. Lines, 243 Fed. (2) 876;
Roberts v. Bank of America, 198 Fed. (2) 919.
Cf: Fed. Trade Com. v. Regulator Co., 97 L. ed. 245, 344 U. S. 206, Syl. 3;
United States v. Schaefer Brewing Co., 356 U. S. 227.

was designed to extend the limited security afforded by chattel mortgages.

The factor's lien agreement may cover merchandise then existing or subsequently acquired. The statute does not require the impossible or the futile.

The important element, in respect to creditors, is the notice of the existence of the lien. Here no creditor was in any wise prejudiced, by the fact that Exhibit A was not physically attached to the lien agreement, even if held essential.

No issue was made in the pleadings, in respect to the failure of the borrower to furnish separate subsequent written statements. The statute required these statements only in respect to merchandise temporarily out of the borrower's custody or possession. The monthly statements, specified by the lien agreement, were furnished by the Summit Hardware, Inc., to Foote. (R. 51, 61.)

As held by the District Court, and by Judge Magruder, in his dissenting opinion, there was a substantial compliance with the Ohio Statute. This is all that is required.[3] Any other holding would enrich unsecured creditors at the expense of the secured lien of Foote.

III.

As to Equitable Lien.

The Court of Appeals held that there could be no equitable lien in favor of Foote. However, an equitable lien may be asserted wholly apart from a factor's lien statute.[4]

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[3] Cf: *San Francisco v. Ryan*, 54 O. S. 307 and *Re National Grocery*, 181 Fed. 33.

[4] *Lewis, Trustee v. Mfg. Natl. Bank of Detroit*, 81 Sup. Ct. 347 (Jan. 9, 1961).

Bankruptcy Courts are invested with jurisdiction at law as well as in equity.[5]

It is the consensual agreement which creates the lien. The enforcement of all liens is a matter of equity. The agreement to give security, in itself, creates an equitable lien.[6]

Bankruptcy courts have exercised these equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates.[7] The trustee in bankruptcy is not a bona fide purchaser for value, so as to bar the assertion of an equitable lien. The trustee stands in the shoes of the bankrupt and his creditors.[8]

Foote, in his cross-petition, sought to reclaim the specific property covered by his lien. The Referee denied him this order and ordered the personal property sold. The trustee took physical possession of the property pledged to secure Foote's lien. Under such circumstances, Foote could assert his lien only in equity and could assert it only as an equitable lien. It does not comport with substantial justice to say that Foote's factor's lien, for mere technical considerations should be defeated in a court of equity.

CONCLUSION.

In conclusion we submit:

First: The question of the timeliness of an appeal, the power of the District Court to extend the time within

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[5] Chap. II, Bankruptcy Act, 11 U. S. C. A. 11.

[6] 33 *Am. Jur.* Sec. 24, page 248.

[7] *Pepper v. Litton*, 84 L. ed. 281, Syl. 3, 4, and 5; 308 U. S. 295.

[8] *Zartman, Trustee v. First National Bank*, 54 L. ed. 418; 216 U. S. 134.
Hauselt v. Harrison, 26 L. ed. 1075; 105 U. S. 401.
In Re National Cash Reg. Co., 174 Fed. Rep. 579.

which to appeal, where the appellant has actual knowledge of the order from which the appeal is made, are important jurisdictional questions.

Second: The order of the Court of Appeals on the question of timeliness of the appeal and the acquisition of its jurisdiction thereunder, is contrary to the decisions of other Courts of Appeals on the same matter and is of such importance that the questions should be adjudicated by the Supreme Court.

Third: The factor's lien agreement here involved was in substantial compliance with the Ohio Statute, and the recorded notice of lien was admittedly in exact compliance with the Ohio Statute. Bankrupt's creditors were charged with notice and knowledge of the factor's lien agreement. No creditor made any inquiries in respect thereto. No one could have been prejudiced by any deficiency in the factor's lien agreement.

Fourth: The order of the Court of Appeals holding that only a legal lien could be asserted by Foote, was clearly erroneous and a denial of the equitable jurisdiction and power of the bankruptcy court.

For these reasons, we submit that the writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX.

A. Referee's Finding and Opinion.

(Filed December 18, 1959.)

This is an action which arose on a petition filed on December 17, 1958 by John A. Schwemler, Trustee, in bankruptcy of Summit Hardware, Inc., to sell the goods, merchandise, hardware, and fixtures of the bankrupt.

The defendant, Everett L. Foote, filed an answer and cross petition for reclamation of personal property offered for sale by the Trustee. The Referee in his discretion may consider the reclamation petition as an answer and objection to the sale of the property in question. This Referee made a Finding on the 13th day of February 1959 that the Trustee had a right to sell said personal property as there was a probable equity in the merchandise, hardware, and fixtures over and above the claimed factor's lien and the chattel mortgage of Everett L. Foote, and ordered transferred from the funds derived from the sale all the alleged claimed liens of Everett L. Foote and deferred to the future the question as to the validity and amount of the said factor's lien and chattel mortgage.

The defendant, Everett L. Foote, claims a factor's lien on all merchandise, hardware, screws, nuts, bolts, work-in-process, tools, and all other chattel property excepting the fixtures in said building and the office equipment by virtue of AGREEMENT FOR FACTOR'S LIEN being marked Reclamation Exhibit No. 3 for purposes of identification, having been executed on the 17th day of December 1957 (2) to secure a loan of Twenty-Five Thousand Dollars and no/100 ($25,000.00) from Everett L. Foote to the bankrupt.

The Trustee, in his reply, alleged that the factor's lien held by Everett L. Foote was not created in accordance

with the statutes of the State of Ohio in that Exhibit A, marked Reclamation Exhibit No. 12 for purposes of identification, referred to in the AGREEMENT FOR FACTOR'S LIEN, Reclamation Exhibit No. 3 was not actually attached to the Agreement creating the lien and the Trustee's reply further claimed that the Reclamation Exhibit No. 3, which was intended to create a factor's lien, was only an agreement to create a factor's lien.

The matter was set down for hearing, all parties being present with their counsel. The Referee heard the testimony and evidence as submitted by both parties. Attorneys Clarence May and K. W. Woodward submitted briefs. The Court having taken the case under advisement and considering the testimony of the witnesses, the evidence, and Exhibits, the oral arguments, and the briefs as filed by both counsel, does hereby make the following finding of facts.

FINDING OF FACTS.

1) That Summit Hardware, Inc. and Henry F. Fritsch individually did on December 17, 1957 execute a note, being marked Reclamation Exhibit No. 2, to Everett L. Foote, for Twenty-Five Thousand Dollars and no/100 ($25,000.00) with interest at the rate of five percent per annum, due six (6) months after date, this note being given as consideration for a loan of Twenty-five Thousand Dollars and no/100 ($25,000.00) from Everett L. Foote to Summit Hardware, Inc.

2) That Everett L. Foote did endorse a check, No. A82174 for Twenty-Five Thousand Dollars and no/100 ($25,000.00) to Summit Hardware, Inc. and it was then endorsed to Evan J. Reed, Trustee for Summit Hardware, Inc. by the corporate officials of the bankrupt corporation,

said check being marked Reclamation Exhibit No. 1 for purposes of identification.

(3) 3) That the chattel mortgage, being marked Reclamation Exhibit No. 5 for purposes of identification, was executed and delivered by Summit Hardware, Inc., to Everett L. Foote as security for the Twenty-Five Thousand Dollar and no/100 ($25,000.00) note due in six (6) months after date and that it was filed for record with the Recorder of Summit County and the Trustee did stipulate that the chattel mortgage was a valid and first lien on those items set forth in the chattel mortgage.

4) Evan J. Reed was counsel and agent at all times during the entire transaction for Summit Hardware, Inc. and did disburse sums amounting to Twenty-Five Thousand Dollars and no/100 ($25,000.00) from an account under the name of Evan J. Reed, Trustee for Summit Hardware, Inc. held at the Dime Bank of Akron, Ohio.

5) The disbursement of the Twenty-Five Thousand Dollars and no/100 ($25,000.00) made by Evan J. Reed was made between December 19, 1957 and February 14, 1958 for payment of creditors, past due accounts, bills, merchandise, and for other unexplained expenditures as set forth in pages 11 and 12 of the transcript of the proceedings.

6) That the AGREEMENT FOR FACTOR'S LIEN, marked Reclamation Exhibit No. 3 for purposes of identification, was executed on the 17th day of December 1957 by Everett L. Foote and the corporate officials for Summit Hardware, Inc. and that a NOTICE OF LIEN OF FACTOR, EVERETT L. FOOTE FROM SUMMIT HARDWARE, INC., BORROWER, marked Reclamation Exhibit No. 4 for purposes of identification, was filed on the 19th day of December 1957 with

the Recorder of Summit County being noted Factor's Lien No. 42. The note, being Reclamation Exhibit No. 2, was not paid when due on June 17, 1958, nor has any payment been made on said note.

7) That Reclamation Exhibit No, 6, marked such for purposes of identification, was a copy of an inventory taken of the merchandise on hand of Summit Hardware, Inc. as of December 31, 1957, being unsigned and undated by the borrower and was delivered to Everett L. Foote by Evan Reed sometime early in January of 1958.

(4) 8) That Reclamation Exhibit No. 12, marked as such for purposes of identification, is a collection of pencil sheet merchandise of Summit Hardware, Inc. tha' was on hand and taken over a period of time extending from February, March, and April of 1957 and is unsigned and undated by the borrower, and does not reflect the merchandise, goods, nuts, screws, tools, and chattel property, that was on hand as of the 17th day of December 1957 and is the Exhibit "A" referred to in the AGREEMENT FOR FACTOR'S LIEN known as Reclamation Exhibit No. 3.

9) That the Reclamation Exhibit No. 12, being Exhibit "A" and referred to in Reclamation Exhibit No. 3 AGREEMENT FOR FACTOR'S LIEN, was not attached to Reclamation Exhibit No. 3 when said instrument was executed and delivered to the factor, Everett L. Foote, and that Evan J. Reed, attorney and agent for Summit Hardware, did make delivery of Reclamation Exhibit No. 12, but some months later.

10) Although there was some testimony of a monthly inventory of purchases being furnished and received by Everett L. Foote there was no evidence or Exhibits of any written, signed, and dated statements by the borrower to the factor of merchandise to be covered by the lien.

11) The note dated December 17, 1957 was due on the 17th day of June 1958 and there was no evidence of an extension of the note, renewal of said note, nor was there any separate written statement, signed or unsigned, by the borrower designating the merchandise that the factor might have a lien on after June 17, 1958.

QUESTION AT LAW.

The issue in this case may be narrowed down to this question: Has the factor complied with the Ohio Revised Code 1311.59 to 1311.64 inclusive to create a valid factor's lien on the merchandise of the bankrupt as of the date of bankruptcy as required by the laws of the State of Ohio?

(5) LAW.

The Trustee, John A. Schwemler, resists the Reclamation Petition as filed by Everett L. Foote claiming an alleged factor's lien by virtue of the Trustee's right, under provisions of Sections 70 (a), 70 (c), and 70 (e) (1) of the Acts of Congress relating to Bankruptcy as amended. These sections deal principally with a Trustee's title to property in Bankruptcy, and the rights he acquires under Federal and State Law applicable thereto.

There is no disagreement between the Trustee and Everett L. Foote as to the applicability of these Bankruptcy Sections to the question at issue. The factor, if his lien is valid, under the laws of the State of Ohio, is then entitled to be paid his claim in full out of the proceeds of the sale; but if the lien is found invalid under the statutes of the State of Ohio, the factor then is a general unsecured creditor and shares in the estate pro rata with all the other general unsecured creditors, with the exception of the property covered by the chattel mortgage, which is not in dispute.

The Federal District Courts in Bankruptcy are governed by the local laws of the State which created the lien law in question. This Court must look to the statute of the State of Ohio and the decisions of the Supreme Court of Ohio in determining the validity of this lien. See *Erie Railroad v. Tompkins*, 304 U. S. 64, 114 ALR 1487; *First National Bank of Cortland v. Logue, Trustee et al.*, 89 O. S. 288, 106 N. E. 21.

The factor lien law of Ohio was enacted in 1945. The first factor lien act in the United States was adopted in New York State in 1911; it is now New York Personal Property Law 45 (1943).

Ohio Revised Code Sections 1311.59 to 1311.64 inclusive sets forth the provisions of the Factor's lien law in the State of Ohio and the necessary steps to be taken to create a factor's lien.

Liens are created by agreements, statutes, or fixed rules of law. It is not the function of the Court to create a lien. See 33 *Am. Jur.* 42 Liens, 6. (6) The Bankruptcy Court seeks not to set aside a valid lien, but must uphold the validity of said lien created under the proper statute, and as a matter of public policy, the lien holder has a right to be protected for funds advanced relying on the security and the law creating the lien.

In the State of Ohio there are two types of liens, the common law and statutory liens. The statutory liens are of two general kinds; those created which were known at common law and having been enacted by statute, and those liens by law which were unknown at common law and have been created by statute. The Mechanic's Lien Law of Ohio 1311.01-1311.38 inclusive is an example of a lien law which creates a lien where there was no common law right in a laborer, material man, sub-contractor, or contractor to perfect a lien on the improved property it-

self, or to file a lien claim on a fund due from the owner to the head-contractor for work done on the job. See 36 *O. Jur.* 2d Mechanic's Liens, page 428, Section 4.

The factor lien law is not found in the common law and the appearance of this statute can be probably attributed to the deficiency of the chattel mortgage statutes and other security devices used with fluctuating inventory.

The general rule of law in Ohio is that a chattel mortgage intending to create a lien on goods which the mortgagor does not own at the time of its execution, but which he contemplates might thereafter be acquired, as against a third party does not constitute a lien upon the property described until the same comes into being and is reduced to possession by the lien claimant. See 9 *O. Jur.* 2d Chattel Mortgages, page 159, Section B (18); *First Security v. Huddle*, 16 O. L. Ab. 241.

The factor's compliance with Section 1311.60 of the Ohio Revised Code is attacked by the Trustee. Section 1311.60 of the Ohio Revised Code reads as follows:

> 1311.60. If it is provided by a written agreement with the borrower, a factor shall have a lien upon such merchandise owned by and in the custody or possession of the borrower, including such merchandise as is temporarily out of (7) the borrower's custody or possession, as is from time to time after the execution of said written agreement designated in separate written statements dated and signed by the borrower and delivered to the factor. Such lien shall secure the factor for all his loans and advances to or for the account of the borrower, together with interest thereon, and also for the commissions, obligations, indebtedness, charges, and expenses properly chargeable against or due from said borrower and for the amounts due or owing upon any notes or other obligations given to or received by the factor for or upon account of any such loans or advances, interest, com-

missions, obligations, indebtedness, charges, and expenses. Such lien is perfected and valid from the time of filing the notice referred to in sections 1311.61 to 1311.64, inclusive, of the Revised Code, whether such merchandise is in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice, or comes into existence subsequently thereto, or is subsequently acquired by the borrower; provided a notice of lien is filed as set forth in Section 1311.61 of the Revised Code.

The factor's lien law further provides that a notation of the filing of the lien must be with the Recorder of the County where the borrower has his principal place of business as set forth in B of Section 1311.61 of the Revised Code of Ohio and Section 1311.62 further provides:

1311.62. Upon the filing provided for in Section 1311.61 of the Revised Code, the lien of the factor shall be effectual upon and shall attach to the property from time to time designated in the written statements provided for in Section 1311.60 of the Revised Code, as against all claims of unsecured creditors of the borrower and as against subsequent liens of creditors. * * *

And having taken these steps as provided for by the Statutes the factor is afforded his lien as set forth in Ohio Revised Code Section 1311.62.

The general rules to be applied to the construction of a Statute on which a lien claimant bases his lien is very important for consideration in this case. A Statute declaratory of a common law lien and not in derogation of it must be given the full limit of the security intended to be provided by the legislature. In other words, there must be a liberal construction for the benefit of the lien claimant. See *M & M Hotel Co. v. Nickels* (App.) 5 O. P. 387, 21 O. L. Ab. 66.

The statutes in derogation of the common law are to be strictly construed, and this rule has been applied to statutes creating liens. The factor lien law of the State of Ohio is a creation of the legislature. Strict construction must be given to the statute to determine the fact of the existence of the lien in any given case. The person claiming the lien must prove strict (8) compliance with the statutory steps which are a condition precedent to the acquiring of the lien; once the lien has attached, the Courts have held that the statute is to receive liberal construction as will carry out the intent of the legislature in creating the lien. *In re: Comet Textile Co.*, 15 F. Supp. 963 (U. S. D. C., S. D., New York 1936). The United States District Court for the Southern District of New York held that Chelsea, the factor, had a lien by virtue of a factor agreement between Chelsea and the bankrupt, and a notice filed pursuant to the New York factor's lien act; no further action was necessary to be done or performed in connection with the perfection of the lien by the factor.

The important difference between the Ohio Statute and the New York Statute is that the New York legislature, in creating the lien, specifically provided in the statute that it was to be construed liberally in order to provide for the creation of the lien as intended by the parties and substantial compliance with its several provisions should be sufficient for the validity of a lien; but the Ohio Legislature did not make such a provision in the Ohio Factor's Lien Law; then the interpretation of the Courts of Ohio of all lien laws, which are in derogation of the common law, is that strict compliance with the statute is necessary in order to create a lien.

The steps necessary to create a factor's lien in Ohio are:

1) A written agreement to create a lien on the merchandise
2) Notice of the lien to be filed with the Recorder of the County
3) Written statements dated and signed by the borrower and delivered to the factor designating the property which the lien shall attach before and after the loan advances be made by the factor.

The Ohio Statute 1311.62 provides that when the four steps as outlined and provided for in Section 1311.60 to 1311.61 of the Revised Code have been taken, a lien is created in favor of the factor and upon property which the borrower subsequently acquires and which from time to time is designated in written statements and dated and signed.

(9) There is only one Ohio reported case covering a factor's lien law; and that is a decision by Referee Herrman of Dayton, Ohio, of the District Court of the Southern District of Ohio, *in Re: Wyse Laboratories, Inc., bankrupt*, 55 O. L. Ab. 321. The *Wyse Laboratories* case involves a factor's lien of a manufacturing concern. Referee Herrman in his statement of facts of the case said:

> The Maxwell Finance Company entered into a factor's agreement which is in evidence as Exhibit I and on the same date the bankrupt executed a statement of himself as borrower setting forth the merchandise to be covered by the factor's lien * * * The Trustee does not question the validity of the factor's lien on the compliance with the provisions of the factor's lien law between the borrower and the factor as of June 25, 1947.

Referee Herrman further said in referring to the ordinary rule of interpretation which requires a strict compliance:

There is no question in this case that there has been a strict compliance with the provisions of the Act regarding the execution of the necessary papers and the filing of notice.

The same cannot be said in this case. Mr. Evan J. Reed, a witness for the factor, admitted on direct examination on questions put to him:

Question: You may state whether or not at the time of the discussion of this agreement for the factor's lien, you had that in your possession (referring to Exhibit A marked Reclamation Exhibit 12).

Answer: Yes, did have it in my possession.

Question: And after the signing of the factor's lien, do you recall whether or not after having examined your own file, do you recall what you did with Exhibit A?

Answer: Well, as I recall it, I said to Mr. Foote, who was at the office at the time. "This is your Exhibit A, which goes with the agreement," and I think he said, "Well, you can hold it here for me." I held it at the office for some time. How long I don't know.

Question: And then later, what is your recollection?

Answer: Later Mr. Foote, I believe, or someone came in and wanted this, and I gave it to them. Either you or Mr. Foote, I don't know who it was. **(10)** May have been two or three months later or more or less. I don't know.

The factor, Everett L. Foote, in his testimony clearly showed that the Exhibit "A" was not an actual inventory as of December 17, 1958, the date of the execution of the AGREEMENT FOR FACTOR'S LIEN, Reclamation Exhibit No. 3, and that the intent was that Summit Hardware, Inc. was to furnish a complete detailed inventory which is the Reclamation Exhibit No. 6.

Nowhere is there any evidence of any dated, signed,

statement of the borrower delivered to the factor designating the property on which the factor's lien would attach.

The factor admitted in his brief:

> The statute requires such intermediate statements only in respect to a borrower, who is engaged in manufacturing or processing; and where the borrower may not have the possession or the control of the chattel property at the time of the making of the agreement creating the factor's lien.

Certainly the evidence showed, and is admitted by the factor, that there were considerable amounts of purchases and sales made after the execution of the Agreement for factor's lien, after the taking of the inventory on December 31, 1957 and after the due date of the note, on June 17, 1958.

The Referee *in re*: *Wyse Laboratories, Inc.* which the factor cites as the only reported case said:

> Keeping those purposes in mind, I cannot find justification for supporting the contention of the Trustee; for should he be right, it would be necessary for the borrower to file a new statement and the factor to give new notice every time a pound of steel or a quart of oil should be purchased by the borrower. I do not believe the Legislature intended that such a situation should obtain, but feel that the provision for filing of amended notices did have in mind changes of the status of the party, or the respective interest.

I concur that the factor is not required to file a new notice of lien as set forth under 1311.61 of the Revised Code whenever new property is acquired by the borrower; but I do think that the intent of the Ohio Legislature was that the borrower would furnish a statement in writing, dated and signed designating the property which the lien would secure. For twice the Ohio Legislature said in

statutes creating the factor lien that the said lien shall

> (11) as is from time to time after the execution of said agreement designated in separate written statements, *dated and signed by the borrower and delivered to the factor* (Ohio Revised Code Section 1311.60). And on the filing provided for in Section 1311.61 of the Ohio Revised Code, the lien of the factor shall be effectual upon and shall attach to the property *from time to time designated in the written statement* provided for in Section 1311.60 of the Revised Code (Ohio Revised Code 1311.62). (Italics added.)

The intent of the Legislature was clear. The property coming into the possession of the borrower would be designated in writing. Then any creditor who was extending credit, or about to extend credit to the borrower, could ascertain after having notice of the lien from the factor, what property was covered by his factor's lien.

The Factor's Lien Law confers a right in derogation of the common law; therefore all steps prescribed by statute to effect such lien must be followed; and in that respect, the law must be strictly construed.

The Supreme Court, in ruling on cases concerned with the Mechanics' Lien Law takes the same position that the procedure for perfecting a mechanic's lien confers a right in derogation of the common law; strict construction must apply to all steps prescribed by statute to perfection of the lien. See *Robert V. Clapp Co. v. Fox*, 124 O. S. 331, 178 N. E. 586. *In re: Rocco Homes Building Co., Inc.*, 23 O. Ops. 516.

Manchester Bank v. Roach, 186 Fed. 2d (827) and *Colbath v. Mechanic's Bank*, 70 Atlanta (2) 608, have been cited by counsel as authorities in this case, both cases having been decided by the New Hampshire Court. The New Hampshire Legislature provided in their factor's lien law:

> * * * all factors shall have a continuing general lien upon all merchandise from time to time consigned to or pledged with them * * * (New Hampshire 446.2).

And the New Hampshire statute further provides:

> * * * this chapter is to be construed liberally to secure the beneficial interest and purpose thereof: a substantial compliance with its several provisions shall be sufficient for the validity of the lien * * * (New Hampshire 446.9).

It is evident from reading the New Hampshire Lien Law that it was adopted from the New York statute and that when the Ohio Legislature adopted the Ohio (12) Lien Law 1311.59 to 1311.64 inclusive that it did not intend to apply the same liberal construction and substantial compliance theory as were provided for in New York and New Hampshire.

As Mr. Charles A. Corry stated in his editorial note on "Ohio Chattel Mortgages and Factor's Lien Law in Inventory Finance," *University of Cincinnati Law Review*, Volume 28, No. 1, Page 102:

> Now with but one journey to the Recorder's Office, the factor can perfect a lien, not only upon the inventory presently owned but on subsequent inventory as well. Compliance with the statute requires the filing of a notice of the written agreement of the factor and the borrower indicating that a lien is given to the factor upon merchandise to be subsequently described in written statements delivered to the factor by the borrower. The lien of the factor on the after acquired merchandise is superior to all when the statute is followed.

The procedure is simple and must be strictly complied with by the factor in order to obtain and maintain his lien on the floating inventory. Certainly with the modern

methods of bookkeeping and inventory control and the requirements of the records to be preserved by the many governmental agencies, it is a simple procedure for the borrower to furnish to the factor a written statement dated and signed indicating the merchandise acquired and upon which the factor's lien is to apply; and in that manner any interested party or creditor could at any time, by looking at these statements, after being put on notice of the lien, tell what merchandise is specifically covered by the factor's lien.

CONCLUSION.

In view of the decisions of the Ohio Supreme Court construing statutory liens in derogation of the common law and the finding of facts in this case, it is the opinion of the Court that the factor has failed to show that he has complied with Ohio Revised Code 1311.59 to 1311.64 inclusive and does not have a valid factor's lien as claimed.

(13) The Trustee is instructed to draw an Order in conformity with the Opinion and Finding of this Court denying the validity of the factor's lien.

The factor may have his exceptions.

Dated at Akron, Ohio, in said district, on the 18th day of December 1959.

H. F. WHITE

Referee in Bankruptcy

B. Court's Memorandum and Order Re Defendant's Petition for Review.

(Filed January 6, 1961.)

This action is before the Court on a petition for review of an order and judgment of the Referee in Bankruptcy, which denied petitioner's (a defendant in trustee's petition to sell personalty) claim of a factor's lien on all the goods, chattels, wares, and merchandise of the bankrupt up to the amount of $25,000, the amount loaned to the bankrupt.

In studying the transcript of proceedings and the various exhibits that were so assiduously prepared by the Referee for the Court's consideration, it appears to us as if the Referee relied primarily upon the fact that the purported factor did not comply technically or strictly with the requirements of Ohio Revised Code § 1311.60 regarding the creation of a factor's lien. Thus the issue decided by the Referee is somewhat more comprehensive than the issue actually created by plaintiff-trustee's answer No. 2 in reply to petitioner's cross-petition for reclamation. In any event, the issue which we deem as confronting us presently is whether Foote sufficiently complied with the provisions of the Ohio Factor's Law, O. R. C. §§ 1311.59-1311.64, so as to have created a valid factor's lien, thereby establishing rights to the personalty of the bankrupt superior to those of the trustee.

The section of the Ohio Factor's Law that the trustee asserts and the Referee finds has not been complied with by Foote, the petitioner, is Section 1311.60, and it reads, in pertinent part, as follows:

> If it is provided by a written agreement with the borrower, a factor shall have a lien upon such merchandise owned by and in the custody or possession of the borrower, including such merchandise as is

> temporarily out of the borrower's custody or possession, as is from time to time after the execution of said written agreement designated in separate written statements dated and signed by the borrower and delivered to the factor. * * * Such lien is perfected and valid from the time of filing the notice referred to in sections 1311.61 to 1311.64 * * *.

Section 1311.61 provides for the filing of the notice of the lien and the recording thereof in the appropriate county recorder's office(s). It is apparently conceded that Foote filed notice of the asserted factor's lien in due time and in due form, so that this procedural requirement is not in issue here.

As is indicated from the above-quoted language, Section 1311.60 contemplates the preparation of two separate written instruments. One is nominated "written agreement" and is the instrument that actually creates the lien, albeit that notice of the lien must be filed in accordance with Section 1311.61 before the lien becomes effective. The second written instrument contemplates a running record of the merchandise that is the security for the lien. To us it is significant that these statements, dated and signed by the borrower, are simply delivered to the factor and apparently are neither intended nor required to be part of the notice given to those who check the factor's lien index in the county recorder's office.

A review of the record before us indicates that Foote and the bankrupt entered into a lengthy written agreement which provided a lien in favor of Foote, as factor,

> "on all its (Summit Hardware, the bankrupt) hardware, screws, nuts, bolts, work in process, tools, merchandise, and all other chattel property * * * including any and all chattel property held for sale * * * to cover the aforesaid note in the amount of Twenty-five-Thousand Dollars ($25,000.00) * * *. Said fac-

> tor's lien shall cover any and all chattel property including nuts, bolts, hardware, tools, supplies, or merchandise hereafter acquired."

It was further agreed that Summit Hardware would furnish Foote each thirty days or oftener a list of all merchandise acquired by it.

It can hardly be doubted that the written agreement fulfilled the first requirement of Section 1311.60, i.e. that the lien is to be created by means of a written agreement between the factor and the borrower. However, it appears, despite some argument by Foote to the contrary, that there were never any separate written agreements dated and signed by the borrower and delivered to the factor which contained the description of the merchandise subject to the lien, despite the agreement of the bankrupt to so provide.

It is because of this apparent failure to comply strictly with the provisions of Section 1311.60 that the Referee based his decision. In so holding, the Referee determined that the present factor's lien statute is in derogation of common law and thus must be construed strictly. Under such a construction, it is understandable that the Referee would determine that the failure to designate the secured merchandise in a separate written instrument was fatal to Foote's claim.

There is some question as to the exact nature of the instant statutory factor's lien, i.e. whether it is in derogation of common law or not. However, as we understand the express statutory law of Ohio, we are bound to afford the Ohio Factor's Law a liberal, not a strict, construction, no matter what the prior common law history might have been. Ohio Revised Code § 1.11 states:

> Remedial laws and all proceedings under them shall be liberally construed in order to promote their object and assist the parties in obtaining justice. The

> rule of the common law that statutes in derogation of the common law must be strictly construed has no application to remedial laws; * * *.

As we understand the underlying purpose of the Factor's law it is highly remedial in nature, enacted to remedy weaknesses in the then prevailing method of inventory financing. See 28 *Cin. L. Rev.* 99. Unless we give the statute a liberal construction we likely violate the purpose of the legislature in enacting it. *Brown & Sons v. Honabarger*, 171 Ohio St. 247 (1960); *Bullock v. Horn*, 44 Ohio St. 420, 7 N. E. 737 (1886).

It is clear from the written agreement creating the lien that both Foote and the bankrupt knew exactly what they were including in the list of property covered by the lien. Also, a reading of the agreement indicates with certainty that all of the bankrupt's inventory, both present and future, was covered by the lien for a period of three years from the date of the agreement, for under Section 1311.59 the use of the term "merchandise" contemplates materials, goods in process, and finished goods intended for sale. See also *In re: Wyse Laboratories, Inc.*, 55 Ohio L. Abs. 321 (1949). No one reading this agreement could have any reasonable doubt as to the intent to create a factor's lien, and as to what property was covered by the lien. This being so, in what way were subsequent and general unsecured creditors of the bankrupt prejudiced by the failure of the bankrupt to execute separate written statements designating the merchandise covered, when these statements are known only to the immediate parties and are not required by law to became a public record? As we read Section 1311.60, the primary purpose of these statements is for the protection and convenience of the parties to the agreement, for unless a third-party checks the factor's lien index first, then notes the factor's name and ad-

dress, and then inquires as to what property is covered by the recorded lien, no one but the factor and the borrower would have knowledge of or use for this separate statement. In the instant case, the notice of the lien was properly filed. If any party with a legitimate interest in the credit status of the bankrupt had discovered the recorded lien notice and then inquired of either Foote or the bankrupt as to what property was covered by the lien, the written agreement would provide him with all of the necessary information. We do not understand how any prospective creditor could have been misled into a sense of false security by the lack of these separate written statements, nor in fact do we read the record of the case as containing any claim that the 'failure' to execute these statements operated to the prejudice of any party, with the exception perhaps of Foote himself who stands to lose a secured loan of $25,000. We think the Ohio Supreme Court in *Brown & Sons, v. Honabarger, supra*, has indicated the policy of Ohio courts on questions like the instant one, and although the case involved the question of a technical failure in the recording of a mechanic's lien, we ask here the same question that was asked by the Supreme Court there: Who was prejudiced by the technical non-compliance of the statute and who did not receive notice of the lien as a result of this non-compliance that either should have or could have? In all fairness to the Referee, who is meticulous in all things, this case had not yet been decided at the time of his decision, and thus he did not have the benefit of what we consider an expression of the policy of the Ohio Supreme Court in this general area of statutory liens. We feel further that the Referee's decision in *In re Wyse Laboratories, Inc., supra*, also supports our position in that it illustrates the need for the continuing use of the factor's lien as an important aid in business financing.

We are thus in agreement with Foote that to disallow his claim of a factor's lien would unjustly enrich the general creditors of the bankrupt by allowing them to share equally in the bankrupt's property that was for the most part available for distribution by the bankruptcy court only because of the $25,000 loan running from Foote to the bankrupt. There was no evidence of fraud or attempted fraud on the part of Foote. Rather, the record indicates a genuine effort on his part to comply strictly with the technical requirements of the statute. The Supreme Court of the United States has said that the equity power of bankruptcy courts "have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done." *Pepper v. Litton*, 308 U. S. 295 at 305 (1939). We think that substantial justice and not technical considerations will prevail only if Foote is restored to the status of a creditor protected by a legitimate factor's lien.

The decision of the Referee is reversed, and the matter is remanded to the bankruptcy court for compliance with the above opinion.

(Signed) JAMES C. CONNELL,
United States District Judge.

C. Court of Appeals' Opinion.

(Decided April 19, 1962.)

Before: MILLER, Chief Judge, WEICK, Circuit Judge, and MAGRUDER, Senior Circuit Judge.

WEICK, Circuit Judge. This case involves the question whether a factor's lien on inventory taken as security for the payment of a loan was valid under Ohio law as against the creditors of the bankrupt borrower.

The material facts, with one exception, were not in dispute.

The bankrupt, Summit Hardware, Inc., an Ohio corporation, was engaged in the business of selling hardware at retail. On December 17, 1957 it negotiated a loan from the factor, Everett L. Foote in the amount of $25,000 to finance its operations and pay creditors. The loan was evidenced by a promissory note executed by the bankrupt to the factor payable six months after date and bore interest of 5% per annum. The loan was secured by a chattel mortgage on certain of the bankrupt's fixtures and a factor's lien on its inventory. The loan was further secured by a pledge of the capital stock of the bankrupt owned by two of its principal officers. The pledge agreement provided that unless the note was paid within one year, Mr. Foote had the option to purchase one-half of the bankrupt's outstanding capital stock for $100.00. In the event the option was exercised, the full amount of the loan would then be payable twenty months after the date of the note and the bankrupt or its shareholders could then satisfy the note and repurchase the shares of stock for the total sum of $50,000.00.

The Agreement for Factor's Lien was executed by the parties on December 17, 1957 and a notice of the lien was duly filed with the recorder of Summit County, Ohio on December 19, 1957. In the agreement the bankrupt

"hereby gives, grants and pledges to the said Factor, Everett L. Foote, a lien on all its hardware, screws, nuts, bolts, work in process, tools, merchandise, and all other chattel property, excepting the fixtures in said building and the office equipment permanently there, including any and all chattel property held for sale, a list of which is attached hereto marked "Exhibit A" and made a part hereof, to cover the aforesaid note in the amount of Twenty-five Thousand Dollars ($25,000.00) and to cover any advances, loans or credits hereafter granted by the said Everett L. Foote. Said Factor's lien shall cover any and all chattel property including nuts, bolts, hardware, tools, supplies, or merchandise hereafter acquired. This lien shall remain in full force until the aforesaid Twenty-five Thousand Dollars ($25,000.00) note and any other advances, loans or payments made by the said Everett L. Foote to or on behalf of said Summit Hardware Inc. are fully paid. It is further expressly agreed that the said Summit Hardware Inc., Borrower, shall be entitled to sell any of said merchandise in the regular course of business, without incurring any liability whatsoever.

It is further agreed that Summit Hardware Inc. shall furnish to Everett L. Foote each thirty (30) days or oftener a list of all merchandise acquired by it and shall at any time at his request furnish a list of all merchandise which it has on hand.

It is also agreed that in the event said note becomes due and payable and is not paid or in the event of any execution being issued against said property or in the event of any receivership or bankruptcy filed by or against Summit Hardware Inc. or any other legal action taken against said Borrower or the Factor deems himself insecure, then the said Everett L. Foote shall be entitled to take possession of such merchandise, heretofore described, as remains on hand and shall be entitled to sell the same at public or private sale, on such terms of credit as he deems proper, and

shall apply the proceeds thereof to the payment of said advances or debts due to the said Everett L. Foote, Factor.

It is further stipulated that in the event Everett L. Foote elects to take over the merchandise heretofore described, then he shall be entitled to liquidate same in such manner as he sees fit, or, if he desires to continue to operate said business, he may do so and over a period of time apply the profits from said operation to the amount owed to him by Summit Hardware, Inc.

This Agreement shall remain in effect for three (3) years from the date hereof but may be renewed from time to time.

In the event said Summit Hardware Inc. is for any reason dissolved or liquidated then said Everett L. Foote likewise shall be permitted to take possession of said goods and merchandise, and sell same as afore set forth."

No "Exhibit A" was attached to or made a part of the agreement.

The fact in dispute between the parties was whether written statements dated and signed by the bankrupt designating the merchandise upon which the lien shall attach had been furnished. Both the Referee in Bankruptcy and the District Court, however, found that no such statements had ever been furnished. We accept this finding of fact.

An involuntary petition in Bankruptcy was filed in the District Court against Summit Hardware, Inc. on September 25, 1958 which resulted in its adjudication as a bankrupt.

The trustee in bankruptcy filed a petition to sell the assets of the bankrupt. The factor filed an answer and cross-petition for reclamation. The trustee filed a reply thereto asserting that the factor's lien on inventory was

invalid as to the creditors of the bankrupt because of failure to comply with the Ohio statutes creating the factor's lien.

The Referee in Bankruptcy adopted findings of fact and conclusions of law and held that the factor's lien was invalid.[1] On review, the District Court reversed and held that the factor's lien was valid. 192 F. Supp. 489 (N. D., Ohio).

Whether the factor had a valid lien must be determined by the recording laws of Ohio. *Holt v. Crucible Steel Co.*, 224 U. S. 262; *Lewis v. Manufacturers National Bank of Detroit*, 275 F. 2d 454, 457 (C. A. 6) affirmed 346 U. S. 603.

The pertinent Ohio statutes providing for the factors lien are as follows:

§ 1311.60 Lien of Factor.

> If it is provided by a written agreement with the borrower, a factor shall have a lien upon such merchandise owned by and in the custody or possession of the borrower, including such merchandise as is temporarily out of the borrower's custody or possession, as is from time to time after the execution of said written agreement designated in separate written statements dated and signed by the borrower and delivered to the factor. Such lien shall secure the factor for all his loans and advances to or for the account of the borrower, together with interest thereon, and also for the commissions, obligations, indebtedness, charges, and expenses properly chargeable against or due from said borrower and for the amounts due or owing upon any notes or other obligations given to or received by the factor for or upon account of any such loans or

[1] The Referee further found that the chattel mortgage was a valid lien in the amount of $874.00 which was the value of the fixtures. The balance of the factor's claim was allowed as a general unsecured claim against the bankrupt's estate.

advances, interest, commissions, obligations, indebtedness, charges, and expenses. Such lien is perfected and valid from the time of filing the notice referred to in sections 1311.61 to 1311.64, inclusive, of the Revised Code, whether such merchandise is in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice, or comes into existence subsequently thereto, or is subsequently acquired by the borrower; provided a notice of the lien is filed as set forth in section 1311.61 of the Revised Code.

§ 1311.62 Superior liens.

Upon the filing provided for in section 1311.61 of the Revised Code, the lien of the factor shall be effectual upon and shall attach to the property from time to time designated in the written statements provided for in section 1311.60 of the Revised Code, as against all claims of unsecured creditors of the borrower and as against subsequent liens of creditors, except that, notwithstanding the prior perfection of the lien of the factor under section 1311.60 of the Revised Code, specific liens arising out of contractual acts of the borrower with reference to the processing, warehousing, shipping, or otherwise dealing with the merchandise in the usual course of the borrower's business, preparatory to their sale, shall be superior to the lien of the factor on said merchandise, whether or not filing has occurred under section 1311.61 of the Revised Code. This section does not obligate the factor personally for any debt secured by such superior lien. When merchandise subject to the lien provided for by sections 1311.59 to 1311.64, inclusive, of the Revised Code, is sold in the ordinary course of the business of the borrower, the purchaser takes the said merchandise free and clear of the lien, whether or not he has knowledge of the existence thereof.

No Ohio cases construing these statutes have been cited to us and we have found none.

The factor was not unknown at common law although he has been subjected to a metamorphosis by legislative enactments. Judge Hartshorne has stated in *In re Tele-Tone Radio Corp.*, 133 F. Supp. 739, 746 (D. C. N. J., 1955) that: "The factor at common law was an agent employed to sell goods for a principal and receive a commission thereon. The factor had a lien on the goods for any advances made by him and for his commission."[2] See also, 35 *C. J. S., Factors*, § 1, p. 496; 22 *Am. Jur., Factors*, § 2, pp. 307-308.

It was emphasized, however, that the common law factor's lien existed independently of any agreement. Judge Hartshorne added at 746 that: "The modern factor, however is . . . a financier who lends money and takes in return an assignment of the accounts receivable or some other security."[3]

Prior to the enactment of the factor's lien law in Ohio, security devices then in use were not adequate to obtain a valid lien against third persons on a fluctuating inventory or after acquired merchandise. The Supreme Court of Ohio in *Francisco v. Ryan*, 54 O. S. 307 held that a chattel mortgage on merchandise was void against creditors of the mortgagor where the mortgagor remained in possession with power of sale; that a provision for lien on after acquired merchandise did not create a present lien or a

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[2] Eugene Freedheim and Eli Goldston, "Article 9 and Security Interest in Instruments, Documents of Title and Good." 15 Ohio St. L. J. 51, 57 (1954). The authors state: "Although this common law lien has been preserved in Ohio, changing business methods have made it unimportant and it has only a remote historical relationship to the statutory factor's lien."

[3] Ohio Rev. Code § 1311.59 (b) defines a factor as: "persons, firms, banks, and corporations, and their successors in interest, who advance money on the security of merchandise, whether or not they are employed to sell such merchandise."

lien when the goods were purchased, but constituted a valid contract for a lien which protected the mortgagee against creditors when the mortgagee took possession of the property.

It will be noted by the express language of both sections R. C. § 1311.60 and § 1311.62 the factor's lien is only upon the merchandise or property designated in separate written statements dated and signed by the borrower and delivered to the factor.

As before stated, both the Referee in Bankruptcy and the District Judge found that no such statements had ever been furnished by the borrower and delivered to the factor.

It is plain, therefore, that the provisions of the Ohio statutes creating the lien have not been complied with.

It is argued that these statutes are remedial in nature like the Ohio Mechanics Lien Law and should be liberally construed. R. C. § 1.11; R. C. § 1311.24; *Brown & Sons v. Honabarger*, 171 O. S. 247.

It should be noted, however, that the Factor's Lien law, unlike the Ohio Mechanics Lien statute, does not contain a specific provision for liberal construction. If R. C. § 1.11, which is relied upon here, was applicable to mechanics liens it is strange that the legislature enacted another statute to the same effect, namely, R. C. § 1311.24.

Notwithstanding the statutory provision for liberal construction of the mechanics lien law the Supreme Court of Ohio held that these statutes were in derogation of common law and must be strictly construed with respect to compliance with the statutory steps to obtain the lien and liberally construed after the lien attached. *Robert V. Clapp Co. v. Fox*, 124 O. S. 331; *C. C. Constance & Sons v. Lay*, 122 O. S. 468. In *Miller v. Kyle*, 85 O. S. 186, 193, the Supreme Court, in construing the Negotiable Instru-

ments Act, said "That statutes in derogation of common law shall not by construction receive a meaning beyond that of the terms which they employ." id. 195.

In the recent case of *Gebhart v. United States*, 172 O. S. 200 the Supreme Court, in an opinion written by Judge Herbert but not in the syllabus, questioned the necessity of the holding in the *Clapp* case relative to the strict construction of the Mechanics' Lien statutes, but agreed with the decision in the *Clapp* case.

It seems clear to us that whether the Ohio Factor's Lien Law is given a strict or liberal construction, the statutory steps to obtain the lien must be substantially followed in order to obtain a lien. In the present case they were not.

Appellee contends that even though the statements were not furnished nevertheless the Agreement for the Factor's Lien sufficiently describes the merchandise. It should be observed that the description of the property conveyed was in general terms and stated that "a list of which is attached hereto marked exhibit "A" and made a part hereof." There was no such list. Consequently the description was incomplete, and, in our judgment, inadequate.

We do not agree that the statutory provisions requiring the describing of the merchandise in written statements dated and signed by the borrower and delivered to the factor were enacted merely for the convenience of the borrower and the factor. The borrower and the factor did not need a statute to create a lien good as between themselves. The purpose of the Factors Lien law was obviously to create a lien on inventory which would be valid as against third persons such as subsequent mortgagees and creditors.

The notice filed with the recorder under the provisions of R. C. § 1311.61 was not required to contain a description of the merchandise. We think the purpose of requiring the dated and signed statements describing the merchandise was to provide written authentic records which third parties could examine and upon which they could rely, in order to ascertain just what property was included in the factor's lien. The records would serve to identify the property subject to the lien in the event of enforcement proceedings.

Finally, it is urged upon us that the factor had an equitable lien because the Factor's Agreement provided that the borrower would furnish the statements to the factor and equity should regard as done that which ought to be done.

The simple answer to this is that the factor's lien is a legal lien, not an equitable lien. Without complying with the statute, the factor's agreement could be treated only as a contract for a lien and it would be necessary for the factor to take possession of the merchandise in order to perfect a lien valid as against creditors. *Francisco v. Ryan, supra*. No statutory lien can be obtained unless the statute was substantially complied with. Since the factor's lien, in the present case, was not good against creditors under Ohio law, it was void against the trustee in bankruptcy. § 70 (c) Bankruptcy Act, 11 U. S. C. § 110 (c); *Schuster v. Wendling*, 116 F. 2d 596 (C. A. 6); *J. M. & L. A. Osborn Co. v. Wells*, 69 F. 2d 970 (C. A. 6).

The judgment of the District Court is reversed and the order of the Referee in Bankruptcy denying the factor's lien is affirmed.

MAGRUDER, Circuit Judge (dissenting). I think that the district court's order was correct and should be affirmed.

The referee's order denied a claim by Everett L. Foote of a factor's lien on certain inventory, which the referee treated merely as an unsecured claim again the bankrupt estate. The district court, on the contrary, ruled that the lien was good and had priority over the claims of the unsecured creditors and over the trustee in bankruptcy, appellant herein, representing those creditors.

The statutory material with which we are concerned is the Ohio Factors Lien Law. The factors lien laws were enacted because of the inadequacy of the chattel mortgage and other familiar security devices. See Silverman, "Factoring: Its Legal Aspects and Economic Justification," 13 Law & Contemp. Prob. 593 (1948). Beginning in New York in 1911, these laws, with more or less variation in detail, are now in force in nearly one half of the States. The Factors Lien Law of Ohio dates from 1945 and is now found in Ohio Rev. Code, §§ 1311.59-64. It is conceded that the law of Ohio applies to this transaction. See *Benedict v. Ratner*, 268 U. S. 353 (1925); *In re Robert Jenkins Corp.*, 17 F. 2d 555 (C. A. 1st, 1927). However, I am not aware of any decision of the Ohio courts on the precise point here in question. Under such circumstances a federal court must do the best it can with the Ohio statutory language, paying heed to any indications that it may find as to how the Ohio courts would probably construe the Ohio statute.

Under the Ohio act, there is no doubt that Everett L. Foote qualifies as a "factor" according to § 1311.59, which describes factors as persons who advance money on the security of merchandise, "whether or not they are employed to sell such merchandise." The bankrupt, Summit Hardware, Inc., is a "borrower," as also defined in § 1311.59. "Merchandise" is stated to mean "materials, goods in process, and finished goods intended for sale,

whether or not requiring further manufacturing or processing, but does not include motor vehicles, whether or not intended for sale, or machinery, equipment, or trade fixtures of the borrower."

What was needed, and what § 1311.60 obviously sought to provide, was a lien upon inventory, conceived of as a "floating mass," which inventory would remain in the possession of the borrower, who would be free to withdraw an item from stock for sale in the regular course of business without any obligation to account to the lienholder for the proceeds. The res which would be the subject of the lien is the merchandise or inventory, whose component elements may be constantly changing with no effect on the identity of the res. Cf. *Hopkins v. Baker Bros. & Co.*, 78 Md. 363, 28 Atl. 284 (1894); *Pullman's Palace Car Co. v. Pennsylvania*, 141 U. S. 18, 26 (1891). I know of no constitutional reason why the legislature of Ohio should not create such a lien if it chooses to do so. In doing this it would not be bound by common law analogies. See *In re Comet Textile Co., Inc.*, 15 F. Supp. 963, 965 (S. D. N. Y. 1936). If this type of lien on the inventory is valid, as I think it is, it is not necessary for a factor to take possession of the merchandise, and thus to accomplish the socially undesirable result of putting the pressed borrower out of business. See *In re Comet Textile Co., Inc., supra* at 964.

The text of § 1311.60 of the Ohio statute is given in the court's majority opinion.

The "written agreement" between the borrower and the factor in this case, after reciting that the factor had lent the borrower the sum of $25,000 evidenced by a note, specified that the borrower "hereby gives, grants and pledges to the said Factor, Everett L. Foote, a lien on all its hardware, screws, nuts, bolts, work in process, tools,

merchandise, and all other chattel property, excepting the fixtures in said building and the office equipment permanently there, including any and all chattel property held for sale," as security for the said loan. "Said Factor's lien shall cover any and all chattel property including nuts, bolts, hardware, tools, supplies, or merchandise hereafter acquired." The agreement went on to state that the borrower should furnish the lender "each thirty (30) days or oftener a list of all merchandise acquired by it and shall at any time at his request furnish a list of all merchandise which it has on hand."

It does not appear that the borrower ever gave the factor a separate written statement dated and signed by him. Both the referee and the district court found this as a fact, and I accept this finding. The referee thought that this absence of a "separate written statement" was fatal to the existence of the statutory factor's lien upon after-acquired inventory. But as it was seen above, in the written agreement between the borrower and the lender in this case, the borrower had contractually bound himself to furnish such "separate written statements," so that, if the borrower performed his contract, that would complete the legal lien according to the Ohio statutes. I see no reason why the equitable lien which thus arises in favor of the factor should not be good as against unsecured creditors or as against the trustee in bankruptcy.

The referee, it seems to me, attaches undue importance to the absence in the Ohio Factors Lien Law of language which is found in the New York statute to the effect that the factor's lien is to be interpreted liberally in order to create a lien as intended by the parties. Since the statutory factor's lien was in derogation of the common law, the referee decided that the statute so imposing the factor's lien should be "strictly construed." He concluded

that § 1311.62 was applicable, with the result that, upon the "filing," as required by § 1311.61, "the lien of the factor shall be effectual upon and shall attach to the property from time to time designated in the written statements provided for in Section 1311.60 of the Revised Code, as against all claims of unsecured creditors of the borrower and as against subsequent liens of creditors."

I entirely agree with the opinion of the court that whether the Ohio Factors Lien Law is given a strict or liberal construction, the statutory steps necessary to obtain the legal lien must be substantially followed in order to accomplish that object. But I rest upon the equitable lien which, while it is not good as against a bona fide purchaser, may be deemed to be valid as against unsecured creditors, under the Ohio law. I think that the spirit of *Brown & Sons v. Honabarger*, 171 Oh. St. 247, 168 N. E. 2d 880 (1960), compels this result.

The lower court was impressed by the fact, which the referee readily admitted, that the factor does not have to file a new notice of lien under § 1311.61 whenever new property is acquired by the borrower and added to inventory and is listed in "separate written statements dated and signed by the borrower and delivered to the factor." See also *In re Wyse Laboratories, Inc.*, 55 Abs. 321, 325 (1949). There may have been some other purposes served by requiring the borrower to issue these "written statements," as set forth in § 1311.61. But certainly the district judge was right in stating that the primary purpose of requiring these separate written statements was "for the protection and convenience of the parties to the agreement." 192 F. Supp. 489, 491. Therefore the court could not "understand how any prospective creditor could have been misled into a sense of false security by the lack of these separate written statements." *Ibid.* at 492.

D. Order Denying Petition for Rehearing.

(May 16, 1962.)

"Upon consideration,

IT IS ORDERED that the petition for rehearing be denied, Judge Magruder dissenting."

E. Ohio Statutory Provisions Involved.

"Title 13—Commercial Transactions

"Chapter 1311—Liens

"Section 1311.60. If it is provided by a written agreement with the borrower, a factor shall have a lien upon such merchandise owned by and in the custody or possession of the borrower, including such merchandise as is temporarily out of the borrower's custody or possession, as is from time to time after the execution of said written agreement designated in separate written statements dated and signed by the borrower and delivered to the factor. Such lien shall secure the factor for all his loans and advances to or for the account of the borrower, together with interest thereon, and also for the commissions, obligations, indebtedness, charges, and expenses properly chargeable against or due from said borrower and for the amounts due or owing upon any notes, or other obligations given to or received by the factor for or upon account of any such loans, or advances, interest, commissions, obligations, indebtedness, charges and expenses. Such lien is perfected and valid from the time of filing the notice referred to in sections 1311.61 to 1311.64, inclusive, of the Revised Code, whether such merchandise is in existence at the time of the execution of the written agreement providing for the creation of the lien or at the time of filing such notice, or comes into existence subsequently thereto, or is subsequently acquired by the borrower; provided a

notice of the lien as set forth in section 1311.61 of the Revised Code.

1311.61 Filing of notice; recording.

* * * * *

Such notice of lien shall be signed by the factor and the borrower and shall be filed within fifteen days after the execution of the written agreement between the factor and the borrower providing for the creation of said lien, in the office of the county recorder in the counties in which the places designated in the notice required by division (B) of this section are located.

* * * * *

"Section 1311.62. Superior Liens. Upon the filing provided for in section 1311.61 of the Revised Code, the lien of the factor shall be effectual upon and shall attach to the property from time to time designated in written statements provided for in section 1311.60 of the Revised Code, as against all claims of unsecured creditors of the borrower and as against subsequent liens of creditors.

* * *"

F. Agreement for Factor's Lien.

This AGREEMENT is entered into this 17 day of December, 1957, by and between EVERETT L. FOOTE, hereinafter designated as the Factor, and SUMMIT HARDWARE INC., a corporation, hereinafter designated as Borrower.

WHEREAS, Factor has loaned to Borrower the sum of Twenty-five Thousand Dollars ($25,000.00) evidenced by a note and chattel mortgage of even date herewith, payable six (6) months from date with interest at the rate of 5 per cent per annum, and

WHEREAS, the parties hereto desire to create a Factor's lien in favor of said Everett L. Foote to secure said obliga-

tion and any further loans or credits granted by Factor to Borrower, and

WHEREAS, such lien is evidenced by notice concurrently filed for record in the Recorder's Office of Summit County, Ohio and

WHEREAS, Summit Hardware Inc. does business at 999 S. High Street, Akron, Ohio, and

WHEREAS the business address of the Factor is 3720 Yellow Creek Road (Bath Township) Akron 13; Ohio.

NOW THEREFORE, the said Summit Hardware, Inc., known as Borrower, hereby gives, grants and pledges to the said Factor, Everett L. Foote, a lien on all its hardware, screws, nuts, bolts, work in process, tools, merchandise, and all other chattel property, excepting the fixtures in said building and the office equipment permanently there, including any and all chattel property held for sale, a list of which is attached hereto marked "Exhibit A" and made a part hereof, to cover the aforesaid note in the amount of Twenty-five Thousand Dollars ($25,000.00) and to cover any advances, loans or credits hereafter granted by the said Everett L. Foote. Said Factor's lien shall cover any and all chattel property including nuts, bolts, hardware, tools, supplies, or merchandise hereafter acquired. This lien shall remain in full force until the aforesaid Twenty-five Thousand Dollars ($25,000.00) note and any other advances, loans or payments made by the said Everett L. Foote to or on behalf of said Summit Hardware Inc. are fully paid. It is further expressly agreed that the said Summit Hardware Inc., Borrower, shall be entitled to sell any of said merchandise in the regular course of business, without incurring any liability whatsoever.

It is further agreed that Summit Hardware Inc. shall furnish to Everett L. Foote each thirty (30) days or of-

tener a list of all merchandise acquired by it and shall at any time at his request furnish a list of all merchandise which it has on hand.

It is also agreed that in the event said note becomes due and payable and is not paid or in the event of any execution being issued against said property or in the event of any receivership or bankruptcy filed by or against Summit Hardware Inc. or any other legal action taken against said Borrower or the Factor deems himself insecure, then the said Everett L. Foote shall be entitled to take possession of such merchandise, heretofore described, as remains on hand and shall be entitled to sell the same at public or private sale, on such terms of credit as he deems proper, and shall apply the proceeds thereof to the payment of said advances or debts due to the said Everett L. Foote, Factor.

It is further stipulated that in the event Everett L. Foote elects to take over the merchandise heretofore described, then he shall be entitled to liquidate same in such manner as he sees fit, or, if he desires to continue to operate said business, he may do so and over a period of time apply the profits from said operation to the amount owed to him by Summit Hardware Inc.

This Agreement shall remain in effect for three (3) years from the date hereof but may be renewed from time to time.

In the event said Summit Hardware Inc. is for any reason dissolved or liquidated then said Everett L. Foote likewise shall be permitted to take possession of said goods and merchandise, and sell same as afore set forth.

This Agreement shall be binding upon the heirs, successors, executors, administrators and assigns of the said Everett L. Foote and the successors and assigns of the said Summit Hardware Inc.

IN WITNESS WHEREOF, the parties hereto affix their hands and seals at Akron, Ohio, this 17 day of December, 1957.

WITNESSETH:

JO ANN DORKA
ANN F. KANE

EVERETT L. FOOTE
SUMMIT HARDWARE INC.
By HENRY F. FRITSCH
President
By LAWRENCE L. KINKER
Secretary-Treas.

(Acknowledgments omitted.)

G. Recorded Notice of Lien of Factor, Everett L. Foote From Summit Hardware Inc., Borrower.

Notice is hereby given that a factor's lien is hereby filed in favor of Everett L. Foote, factor, said lien being granted by Summit Hardware Inc., a corporation, borrower;

(A) The name of the factor is Everett L. Foote; the name under which the factor does business is Everett L. Foote; the principal place of business of the factor within this state is 3720 Yellow Creek Road (Bath Township), Akron 13, Summit County, Ohio; the factor has no place of business outside the State of Ohio; the factor is an individual;

(B) The name of the borrower is Summit Hardware Inc.; the principal place of business of the borrower within this state is 999 South High Street, Akron, Summit County, Ohio; the borrower is a corporation organized under the laws of Ohio and the location of its principal place of business as designated by the Records in the Office

of Secretary of State is Akron, Ohio; the place in Ohio at which the merchandise is, or may be located or stored is 999 South High Street, Akron, Ohio;

(C) The date of the written agreement between factor and borrower is December 17th, 1957, and the period of time during which loans or advances may be made against merchandise under the terms of said agreement is three (3) years.

Executed at Akron, Ohio on December 17, 1957.

WITNESS:
EVAN J. REED
JO ANN DORKA

EVERETT L. FOOTE, *Factor*
SUMMIT HARDWARE INC.
By: HARRY F. FRITSCH
President
By LAWRENCE L. KINKER
Secretary Treasurer
Borrower

Factors Lien No. 42
Filed Dec. 18, 1957